# Understanding Accounting Terminology Checklist

An essential skill for any manager is to have a clear and accurate understanding of accounting terminology and the process involved in the compilation of the key financial statements an organization must produce.
There are two types of accounting processes that record the financial transactions of an organization:

- Financial Accounting
- Management Accounting

| Financial Accounting | Management Accounting |
|---|---|
| Show what has happened historically over a period, usually a year, providing its readers with an accurate assessment of an organization's financial status. | Is used by management to assist with forward planning and aid controlling and analyzing an organization's efficiency of its operations. |
| Historic review of financial performance.<br><br>Users:<br>▪ Investors & Shareholders<br>▪ Potential Buyers<br>▪ Management<br>▪ Competitors<br>▪ Tax Authorities<br>▪ Consumers | Focuses on forward planning & is used internally as an aid in the decision making process.<br><br>Users:<br>▪ Owners<br>▪ Management<br>▪ Employees |
| Produces the financial statements:<br>▪ Profit & Loss accounts<br>▪ Balance Sheet<br>▪ Cash Flow Statement | Produces financial outputs such as:<br>▪ Financial Forecast<br>▪ Budgets & Costing<br>▪ Contribution Statements<br>▪ Break Even Charts |
| Their production must meet legal requirements imposed on an organization. | Processes are defined by the organization to meet their operational requirements. |

**Accounting Concepts:**
All accounts are produced by adhering to four fundamental concepts:

- Going Concern – the future operation of the organization is assumed.
- Accruals or Matching principle – revenues and costs are recognized in the period they occur.
- Prudence or Conservatism – provides an objective financial view by acknowledging expenses & losses as they become known and realizing revenue when it becomes 'real'.
- Consistency – is applied to cost allocation and asset valuation so that comparisons can be made.

**Conventions within Accounting:**
There are five basic conventions the accounting world has adopted over time, These conventions are:

- Objectivity
- Separate entity
- Money measurement
- Historical cost
- Double entry

You should ensure that you are familiar with your country's set of legal & professional standards.

| Alphabetical Definition of Accounting Terms | |
|---|---|
| **Accounts payable** | Represents those amounts owed to creditors. |
| **Accounts receivable** | Details debts that are owed to the organization. |
| **Accruals** | Is an allowance for costs that have not yet been invoiced. |
| **Accrued Payroll** | Represents the amount earned by employees, but which has yet to be given paid, as most people are paid in arrears. |
| **Accumulated depreciation** | Allows an organization to depreciate its assets in a controlled and uniform way. |
| **Adjustments.** | These are all the operating items that had an impact on cash that were not included in the income statement – depreciation, accounts receivable, prepaid expenses, inventory and accounts payable |
| **Amortization** | Defined as spreading payments over multiple periods for loans and intangible assets, such as patents and intellectual property. |
| **Assets** | Describes items such as stock/inventory, buildings, equipment, and money owed to the organization |
| **Bad Debt** | Can be described as a debt that all reasonable means to collect have been tried and they have failed to get payment.<br>This amount is written off as a loss and becomes categorized as an expense (reducing net income) on an income statement. |
| **Bad Debt Reserve** | Assigns a percentage of total sales as a bad debt expense. The percentage is calculated from the historical proportion of sales that were never paid. |
| **Balance Sheet** | An itemized financial statement that summarizes the assets and liabilities of the organization at a *given date*. |
| **Balance sheet insolvency** | Involves having negative net assets. That is when an organization owes others more than it has in assets, including the money that it is owed. |
| **Bankruptcy** | It is a determination of insolvency made by a court of law with resulting legal orders intended to resolve the insolvency. (It is not the same as insolvency) |
| **Book value of an asset** | Original purchase price of an asset. |
| **Capital employed** | The net amount invested in an organization by its investors or owners. It is taken from the balance sheet |
| **Capital Expenditures** | The amount spent for all fixed assets that are not charged to expense when purchased but are recorded on the organization's balance sheet. |
| **Capital Stock and Contributed Capital** | Capital stock is the amount paid into the organization by investors to purchase stock at some nominal amount per share |
| **Cash** | Refers to those current assets that are immediately, or as soon as, turned into currency. Predicting and anticipated the cash flow of an organization is essential to its survival. |
| **Cash flow forecast** | Is an internal document produced on an ad hoc basis, usually monthly, to help with budgeting and planning. |
| **Cash flow insolvency** | Refers to a lack of funds to pay debts as they fall due. |
| **Common-size financial statement.** | Expresses the income statement in percentages only and allows one to compare different sized organizations |
| **Cost of Goods Sold** | This is the purchase cost of 'goods' that were subsequently sold to customers. |

| | |
|---|---|
| **Creditor** | Someone whom the business owes money to, e.g. a supplier, landlord, or utility organization. |
| **Current Assets** | Are those assets with the value available entirely in the short-term; a period of less than a year and can be quickly liquidated. It includes cash and cash equivalents, short-term investments, accounts receivable, and bad debt provision. |
| **Current Liabilities** | Those items that will become due, or must be paid, within one year.<br>Liabilities include payables such as wages, accounts, taxes, and accounts payable, unearned revenue when adjusting entries, portions of long-term bonds to be paid this year, and short-term obligations (e.g. from purchase of equipment). |
| **Current Portion of Long-term Debt** | Is the portion of the debt that must be repaid within the next 12 months. |
| **Debtor** | Someone who owes the organization money e.g. a customer for goods delivered. |
| **Deficit in Retained Earnings** | Means that an organization has made a sustained loss and needed to draw on its retained earnings. |
| **Depreciation** | Assets have a certain length of time in which they operate efficiently, referred to as 'an asset's useful life.' During this period the value of that asset depreciates due to age, wear and tear, or obsolescence.<br>The loss in value is recorded in accounts as a non-cash expense, which reduces earnings whilst raising cash flow. |
| **E.B.I.T.D.A. or EBITDA.** | This acronym stands for - Earnings Before Interest, Taxes, Depreciation, and Amortization. It is a modified way of presenting operating income for organizations that are not concerned about the financially based charges that it excludes. |
| **Equity / shareholder equity** | Consists of issued capital and reserves, both controlling interests, as in a parent or holding organization, and non-controlling interest in equity.<br>Includes loans from shareholders, capital stock and contributed capital plus retained earnings. |
| **Expenses** | Outgoing assets or liabilities incurred. |
| **Expenses** | Refers to the other costs that are not matched with sales as part of the cost of goods sold. They may be matched with a specific time, usually monthly, quarterly, or annually or they may also be one-off payments.<br>Expenses include: staff wages, rent, utility bills, insurance, equipment, etc. |
| **Expenses Involved in Primary Activities** | All of the costs incurred during the period of the income statement in order to earn normal operating revenues. |
| **Financing** | This section of a cash flow statement reports the issuance and repurchase of the organization's own bonds and stock and the payment of dividends. |
| **Fixed Assets** | Refers to all items owned by an organization that will have a value over a long period, usually any time longer than one year. It includes freehold property, plant, machinery, computers, motor vehicles, etc. |
| **Gains** | Refers to items within an income statement that are derived from the sale of long-term assets and are reported on the income statement as the net of two amounts: the proceeds received from the sale of a long-term asset minus the amount listed for that item on the company's books. |
| **Gross Profit / Gross Margin** | Refers to what is left after you subtract the cost of goods sold from the sales. |

| | |
|---|---|
| **Horizontal common-size analysis** | Is one option you can use when performing a common-size analysis and compares the change year on year for each item of both the income statement and the balance sheet. |
| **Income Statement** | An accounting of revenue, expenses, and profit for a *given period*.<br>Often an internal document used to make management decisions about almost any activity where you have a record of the money spent and the associated return. |
| **Insolvent'** | The inability of a debtor to pay their debt. It can result from either cash flow insolvency or balance sheet insolvency. |
| **Intangible assets** | Are items like patents, trademarks and goodwill |
| **Inventory / Stock** | Consists of three components: *Raw materials* – these are the materials required to produce goods. *Work in process (WIP)* – includes partly finished goods and those raw materials and components already committed to production. *Finished goods* – are all those goods ready to be sold. |
| **Investing** | This reports the purchase and sale of long-term investments and property, plant, and equipment in the cash flow statement. |
| **Investment** | Those such as shareholders see a return on their investment (shares) in an organization. |
| **Key financial ratios** | These ratios assess the financial performance of an organization. They are derived from information in the organization's income statement, balance sheet, cash flow statement, and statement of retained earnings. |
| **Liabilities** | Details money owed by the organization to suppliers and its own workers in the form of wages that have not yet been paid. |
| **Liquidity** | The organization's ability to meet its short-term obligations. This includes such items as how much working capital it requires and its debt obligations. |
| **Liquidity** | This is the ability to meet current obligations with cash or other assets that can be quickly converted into cash in order to pay bills as they become due. |
| **Loans from Shareholders** | Often seen on the balance sheets of privately owned organizations owners can put money into their organization when it is needed and take it back again when it isn't. |
| **Long-term debt** | Money borrowed with very long payment terms.<br>The balance sheet will show the portion of such a loan that is due to be paid within the next 12 months in current liabilities. |
| **Long-term liabilities** | Includes any debts and other non-debt financial obligations that are due after a period of at least one year from the date of the balance sheet.<br>For example, issued long-term bonds, notes payable, long-term leases, pension obligations, and long-term product warranties |
| **Losses on Income statements** | Means the proceeds from the sale of long-term assets or a transaction that is outside of an organization's primary activities is less that the book value. |
| **Mark-up** | Is the figure, or percentage, added by management to cover the cost of goods and provide additional revenue to achieve the required profit margin on its sales. |
| **Minority interest,** | Is the portion of an organization's stock or shares not owned by the parent. |
| **Net Cash Flow** | This figure should be equal to the actual change in cash balances from the beginning to the end of the period of the report. |
| **Net Income** | The difference between Revenue and Expenses. |
| **Net profit** | Is the figure left after all operating and non-operating expenses have been |

| | |
|---|---|
| | deducted from total revenue or income. |
| **Non-operating expenses or Expenses from Secondary Activities** | All of the costs incurred during the period of the income statement for example, interest expense is a non-operating expense because it involves the finance function of the organization, rather than the primary activities |
| **Non-operating items / Expenses** | Details any revenue and expense information about activities that are *not tied directly* to these operations when creating an income statement |
| **Notes Payable and Other Bank Debt** | Includes such items as bank loans that represent borrowed money. These loans and its associated repayments typically have special terms and need to be recognized in their own right. |
| **Operating items / Expenses** | Provides information about revenues and expenses that are a *direct* result of regular organization operations when creating an income statement |
| **Operations** | Is the process of running the organization with all of the related cash flows such as buying and selling goods, services, manufacturing, and wages.<br>The entries under this title effectively convert the items reported on the income statement from the accrual basis of accounting to cash. |
| **Other Accrued Liabilities** | Includes those expenses that have been incurred, but not yet received an invoice for. An estimated figure is used rather than wait for an invoice with an exact figure in the financial statement. |
| **Other Operating Expenses** | This heading on an income statement includes such costs as research and development (R&D), sales and marketing, general and administrative and EBITDA. |
| **Performance** | Judges an organization's ability to grow at a similar rate to others within its sector. This growth can be measure in terms of profit and efficiency. |
| **Prepayments Or Pre-paid expenses** | Is an allowance for costs allocated monthly or quarterly as necessary, for a sum or annual fee that has been invoiced and paid in advance e.g. insurance premiums, property taxes, and income tax installments. |
| **Profitability** | An organization's use of its assets and control of its expenses is sufficient to generate an acceptable rate of return. |
| **Property and equipment** | Includes such items as buildings, manufacturing equipment, vehicles, and office equipment. |
| **Provisions.** | Liabilities of uncertain value or timing |
| **Receipts occur** | When cash is *received*. |
| **Retained Earnings** | In times of profit money can be added to retained earnings and when losses are incurred it reduces these retained earnings. |
| **Return on Assets** | Measures the level of profit compared to the value of net assets invested in an organization. (Assets are the major items that need to be in place for the organization to operate.) |
| **Revenue** | Incoming assets in return for sold goods or services. |
| **Revenue From Secondary Activities** | Are often referred to as non-operating revenues and are those that an organization earns outside of selling goods and services. For example, interest paid to the company by the bank for cash on deposit or payments received for the lease of spare office space. |
| **Revenues From Primary Activities** | Often referred to as operating revenues and are only those revenues derived from the provision of sales or services depending on the nature of your organization. |
| **Revenues occur** | When money is *earned*; |
| **Sales or Revenue** | Revenue is the income that flows into an organization, and it is often used |

| | |
|---|---|
| | almost synonymously with sales.<br>*In government and nonprofit organizations it includes taxes and grants.* |
| **Short-Term Investments Sold** | Details excess cash that has been invested gaining interest until it is needed for operations.<br>This type of investment is usually short term and uses vehicles like bank certificates or securities, which the organization sells when it needs the cash. |
| **Solvency** | The ability of an organization to sustain its activities into the future, i.e. it can pay its debts as they fall due, which means there is enough working capital to pay its suppliers. |
| **Statement of Cash Flow** | A financial statement that reports the effect of all transactions that involved or influenced cash but did not appear on the income statement. |
| **Supplemental Information** | Within the cash flow statement this section reports the exchange of significant items that did not involve cash and reports the amount of income taxes paid and interest paid. |
| **Tangible Assets** | Are items that are physical in nature and include cash, inventory, buildings, equipment, and accounts receivable. |
| **Total Net Assets** | Can be calculated by taking total liabilities from total assets and represents the amount of capital invested in the organization. The balance sheet will show a figure for net assets. |
| **Vertical Common-Size Analysis** | Is one option you can use when performing a common-size analysis and expresses inventory, liabilities, and equity as a percentage of total assets. |
| **Working Capital** | This is the difference between current assets and current liabilities.<br>An organization without sufficient working capital cannot pay its debts as they fall due. In this situation it may have to stop trading even if it is profitable. |
| **Working Capital Management** | Involves actively controlling inventories, accounts receivable, accounts payable, and cash. |